SWIDLER BERLIN SHEREFF FRIEDMAN, LLP

THE WASHINGTON HARBOUR
3000 K STREET, NW, SUITE 300
WASHINGTON, DC 20007-5116
TELEPHONE (202)424-7500
FACSIMILE (202) 424-7645
WWW.SWIDLAW.COM

RICHARD M. RINDLER

DIRECT DIAL (202) 424-7771
RMRINDLER@SWIDLAW.COM

NEW YORK OFFICE
THE CHRYSLER BUILDING
405 LEXINGTON AVENUE
NEW YORK, NY 10174
(212) 973-0111 FAX (212) 891-9598

September 2, 2004

VIA ELECTRONIC FILING

Marlene R. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: ***Ex Parte*, Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92**

Dear Ms. Dortch:

Pursuant to Section 1.1206 of the Commission's rules, this will provide notice that on September 2, 2004, John Sumpter (Vice President – Regulatory, Pac-West Telecomm, Inc.), Wanda Montano (Vice President-Regulatory, US LEC Corp.), and Russell C. Merbeth (Federal Policy Counsel, Eschelon Telecom, Inc.), on behalf of the Cost-Based Intercarrier Compensation Coalition, and the undersigned met with Victoria Schlesinger (PPD), Steve Morris (WCB/PPD), Jane Jackson (WCB/OBC), Theodore Burmeister (WCB/TAPD), Margaret Dailey (WCB/OBC), Robert Tanner (OBC), and Monica Desai (WCB/PPD). In this meeting, we discussed the Cost-Based Intercarrier Compensation Coalition proposal for a Unified Intercarrier Compensation regime and its relation to other proposals. The attached materials were discussed.

Sincerely,

Richard M. Rindler

cc: Victoria Schlesinger (PPD)
Steve Morris (WCB/PPD)
Jane Jackson (WCB/OBC)
Theodore Burmeister (WCB/TAPD)
Margaret Dailey (WCB/OBC)
Robert Tanner (OBC)
Monica Desai (WCB/PPD)
John Sumpter
Wanda Montano
Russell C. Merbeth

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COST-BASED INTERCARRIER COMPENSATION COALITION

- CBICC supports the goals of intercarrier compensation reform:

  - elimination of improper arbitrage incentives and opportunities;
  - elimination of unequal treatment of call types and different carrier types;
  - aligns compensation with economic costs;
  - an easily administered regime;
  - politically achievable solution.

- Advantages of CBICC Proposal:

  - A unified intercarrier compensation rate based on economic costs would rationalize pricing, address arbitrage opportunities.
  - Easier to implement and administer because it builds on current CPNP system.
  - Assures carriers of compensation for use of their networks.
  - Facilitates interconnection by providing for compensation.
  - The correct price is already determined and available– the state set TELRIC rate for local switching and termination.
  - TELRIC affirmed by Supreme Court.

- The Commission should reject intercarrier compensation reform plans that seek to protect incumbents disproportionately from the risk of revenue loss.

- Problems with mandated "bill-and-keep."

  - Unlawful under Section 252 when traffic is out-of-balance because no "mutual recovery of costs."
  - A rate of zero is not a just and reasonable rate under Section 201.
  - Advantages ILECs: better able to recover costs from end users, and to subsidize business services by shifting costs to consumers.
  - Would require new federal regulatory programs to supervise ILEC end user recovery.
  - Preserves arbitrage opportunities by encouraging traffic origination.
  - Encourages and rewards inefficient network design by creating incentives to hand-off traffic as early as possible.

- Disadvantages of ICF plan (many details unclear).

  - Apparently designed to protect ILECs and IXCs, but not CLECs or CMRS providers.
  - As explained, bill-and-keep should not be the goal.
  - ILECs would have the incentive and ability to shift costs to wireline and wireless local service competitors by manipulation of interconnection points.
  - Hierarchical vs. non-hierarchical networks is a formula for discrimination in favor of incumbent legacy networks.
  - Complicated and costly to implement.
  - Overburdens USF.

Cost Based Intercarrier Compensation Coalition ("CBICC") Proposal

PROPOSAL; A UNIFIED COST-BASED APPROACH FOR THE ORIGINATION AND TERMINATION OF ALL CIRCUIT-SWITCHED TRAFFIC EXCHANGED AMONG LICENSED COMMON CARRIERS, WITH MINIMAL END USER RATE INCREASES

A unified intercarrier compensation system is preferable to the current set of different intercarrier regimes only if it eliminates improper arbitrage incentives and opportunities, is easily administered, reflects economic costs, and is politically achievable. A theoretically perfect unified intercarrier compensation system is not attainable and pursuit of such a system diverts resources from either fixing defects of current systems or from adopting a viable cost-based plan.

A review of various public proposals to address the issues raised by the Commission's effort to develop a unified intercarrier compensation system shows a significant degree of consensus about the issues that need to be addressed and how to address them. Among the public proposals, none favor the immediate adoption of bill-and-keep for all traffic. Most oppose bill-and-keep as a matter of legal limitations on the FCC's use of that approach as well as policy reasons demonstrating the inappropriateness of such an approach .[1]

The EPG, ARIC, RLECs, CBICC proposals all call for a unified cost-based rate for the termination of all circuit-switched traffic, regardless of jurisdiction (interstate or intrastate), type of carrier (LEC,IXC,CMRS,VoIP) involved or the nature of the service (voice/data). While there are differences as to whether the rate is based on embedded costs, TELRIC, or some other cost methodology, a single rate for the same functions is the *sine qua non*. There also is agreement that the rate should be charged on a minutes-of-use basis, at least as an initial matter.

CBICC believes that the use of the state established TELRIC rate for local switching, transport and termination is the correct rate – both as a theoretical matter and as a matter of administrative simplicity. TELRIC rates are competitively and technologically neutral and reflect underlying costs. A single rate for each relevant function would be set for each ILEC in each state. In those states where TELRIC rates do not currently exist for a particular ILEC, the FCC could set an interim rate based on the average TELRIC by state or nationally. That rate would be adopted pending state development of state specific, ILEC specific TELRIC rates. Based on information available to CBICC, the current national average of TELRIC rates for transport and termination of calls is approximately $0.00212.

The use of TELRIC has the benefit of being a legally tested approach which has the approval of the Supreme Court, has been successfully utilized by the states in proceedings open to all interested parties, and has the flexibility to be changed relatively easily to reflect changed circumstances. While TELRIC is based on ILEC in-puts, it is intended to produce forward looking costs of an efficient carrier using efficient technology. While some non-ILEC carriers may have lower costs, some will have higher costs. Given the size and scope of the ILEC networks, it is reasonable for the FCC and the States to use ILEC forward looking costs as

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[1] *See* CBICC "The FCC Should Not Adopt Bill-and-Keep." (Tab A)

representative of competitors' costs. If a carrier desires to prove it has higher costs, that should be permitted .

An intercarrier compensation rate based on TELRIC encourages competition by ensuring that requested carriers have an economic incentive in interconnecting to carry the traffic and to provide high quality service.

How the CBICC Proposal Works

Unless otherwise agreed by the parties, in the case of circuit-switched traffic involving two carriers, the originating carrier compensates the terminating carrier for the cost of transport and termination. In the case of circuit-switched traffic involving three or more carriers , the call is exchanged on a sent/paid basis. That means that the carrier with the retail relationship with the originating caller pays all other carriers whose networks are used to complete a call. In those cases in which the IXC has the retail relationship with the calling party for the call (i.e. the calling party is PIC'd to the IXC), or when the call is sent "collect", the IXC also pays the originating carrier the originating switching rate, since the IXC collects the revenue from the end user.

At the end of all transition periods, the intercarrier compensation rate for all circuit-switched traffic will be the blended TELRIC rate for tandem switching (TELRIC for tandem switching, end office switching, and interoffice transport).

Interstate access rates will immediately decline to this baseline rate. Any loss of revenue will be offset by a capped increase in an end user charge, and the availability of USF funds in the unusual circumstance of the need to recover any remaining shortfall. It is expected that, while all carriers will be entitled to utilize an end user charge supplement, only rural carriers will possibly need USF funding. This use of USF funds will last as long as necessary to phase-in a carrier's end user charge supplement at no more than 50 cents per year. A carrier must first apply the full capped end user charge supplement before seeking any revenue from the USF for this purpose. If used, end user charge supplements must be applied initially to business customers and then, if necessary, to residential customers.

Intrastate rates will also decline to the baseline rate, but the schedule will not necessarily be the same as for the interstate rates. CBICC proposes that the FCC refer the matter to the state commissions and a Joint Board. The Joint Board will propose implementation terms, including end user charge supplements, federal USF increases, and transition periods for intrastate rates. In the alternative, state commissions may order intrastate rates to decline to or toward the baseline rate, with any shortfall to be recovered through state USF funding mechanisms.

If not already compensated at the baseline rate, the compensation rate for all 251(b)(5) traffic and ISP-bound traffic will move immediately to the baseline rate. There will be no growth caps or new market restrictions on any circuit-switched traffic.

Transit carriers will charge TELRIC rates for the functions actually provided (tandem switching and/or interoffice transport).

The current interconnection rules remain in place, namely CLECs may designate a single point of interconnection per LATA. Rural carriers will not bear transport obligations beyond their service boundaries.

CBICC proposal covers VoIP traffic to the extent that it originates or terminates as circuit-switched traffic. The IP market has evolved so that noncircuit-switched traffic between IP networks is handled through peering arrangements or through negotiated rates. These market mechanisms work because at present there are no monopoly IP carriers.

CBICC proposal eliminates concerns over improper arbitrage between intrastate, local and interstate traffic. It eliminates concerns with respect to intercarrier compensation involving EAS traffic, CMRS traffic, VNXX traffic, ESP traffic, ISP-bound traffic and circuit-switched VoIP traffic. It eliminates concerns about misreporting jurisdiction, and stripping CPN. Proposal should be simple to administer and implement as it relies on existing work done by states in establishing TELRIC rates. The proposal does not in any way prohibit carriers from entering into voluntary arrangements incorporating bill-and-keep or any other compensation mechanism, but in the absence of such an agreement, it ensures facilities based carriers of reasonable cost-based compensation for the use of their networks.

TAB A

Cost-Based Intercarrier Compensation Coalition

The FCC Should Not Adopt Bill-and-Keep

1. Imposing bill-and-keep would be unlawful.

- Bill-and-keep does not provide for the "mutual recovery of costs" required by Section 252 when traffic is not in balance. It also would not provide recovery of the "additional costs of terminating such calls" as required by Section 252.
    - This is consistent with the FCC's conclusion in the Local Competition Order (paras. 1033-1034).
- Bill-and-keep is not "just and reasonable" and therefore would violate Section 201. A rate of zero, imposed without the consent of the carrier incurring the cost, is not just and reasonable.
- AT&T, one of the advocates of the ICF plan, said in 2001 that imposing bill-and-keep across the board would violate the Act. Similarly, in 1996, Ameritech, Bell Atlantic, BellSouth, GTE, NYNEX, Pacific Bell, SWBT and U S West all took the position that imposing bill-and-keep would be unlawful. U S West went so far as to say "bill and keep arrangements are economically wasteful arrangements." USTA filed a report in 1996 titled "Bill and Keep: A Bad Solution to a Non-Problem." SBC even defied the Texas PUC when it ordered SBC to adopt bill-and-keep arrangements for the first 9 months under its interconnection agreements. BellSouth's position throughout the first round of negotiations in 1996 was that the reciprocal compensation rate should be its access charge rate less the Carrier Common Line charge (approximately 2.5 cents per minute).
- The Telecom Act expressly allows carriers the option of agreeing to "arrangements that waive mutual recovery" of costs. Many carriers with reasonably balanced traffic volumes currently exchange traffic on a bill-and-keep basis, but such arrangements must be consensual.

2. Bill-and-keep would not solve "the problems" identified by the FCC.

- A key criticism of present systems is the existence of arbitrage opportunities. Bill-and-keep does not correct that problem. Arbitrage opportunities will arise whenever the rate charged for a service differs substantially from the cost incurred to provide the service. It is as true when rates are too high (such as the 4 cents per minute rate tariffed by NYNEX in Massachusetts for reciprocal compensation in 1996) as when rates are too low (a rate of zero will encourage overuse of other parties' facilities).
- Traffic imbalances are not necessarily inappropriate or harmful. They may indicate appropriately targeted service to a particular market niche, which should not be discouraged. The Commission should not be in the business of defining what types of product sets and customer mixes a carrier should be serving. The Commission should be promoting, not discouraging, service to market niches because this is the only way to prevent ubiquitous cross-subsidization of services by the ILECs. For

example, unless a competitor is able to target niche markets such as high-volume call originators, an ILEC would be able to overcharge end users that are high-volume call originators in order to subsidize high-volume call terminators. Service to market niches is nothing more than identifying, and responding to, market opportunities.

- To the extent traffic imbalances are at the heart of ILEC problems with reciprocal compensation, the BOCs created the problem and a cost-based rate would have avoided it. The irony is that the Commission was right in 1996 when it set the end-office proxy switching rate at $0.002-$0.004. Had ILECs agreed to that rate, rather than demand rates as high as 4 cents per minute (USTA proposed a rate of 1.3 cents per minute to this Commission in 1996), CLECs might not have been as willing to seek out customers with high volumes of terminating traffic. Along those lines, Bell Atlantic hit the nail on the head in its 1996 Reply Comments to the FCC: if reciprocal compensation rates were set too high, CLECs will <u>respond</u> by seeking out customers with high inbound call volumes. Knowing this, the BOCs still set the rates too high because they apparently assumed there would be a traffic imbalance in their favor. As a result many CLECs did seek out customers with lucrative balances of traffic.

- ILEC's do not need bill-and-keep to solve traffic imbalances. ILECs have choices – they may avoid intercarrier compensation by competing to serve, for example, ISPs. Were ILECs to focus on meeting their customers' needs rather than jousting with the regulators, customers would not migrate from ILEC networks to the CLECs. Where ILECs have succeeded in fighting compensation, they do not need to compete, and they do not incur uncompensated call completion costs on their own networks.

- TELRIC terminating switching rates should reflect the best available technology. If ILEC terminating switching rates appear to exceed the costs to a CLEC to terminate traffic, then the TELRIC rate does not reflect the best available technology and should be revised accordingly through a TELRIC proceeding.

3. <u>The Network Architecture Revisions That Would be Required Under Bill-and-Keep Are Unlawful and Would Significantly Harm CLECs</u>

- The Commission's proposed bill-and-keep arrangements—COBAK and BASICS—require certain network architecture revisions in order to justify forcing the terminating carrier to terminate calls without compensation. COBAK, for example, requires the originating carrier to deliver traffic to the terminating carrier's end office serving the called party. These network architecture revisions are not consistent with the Telecom Act. The Act permits CLECs to interconnect at "any technically feasible point within the carrier's network." Compelling interconnection at ILEC end offices contradicts this statutory requirement.

- The proposed network architecture revisions would impose enormous transport costs on CLECs by essentially requiring them to duplicate the ILEC's hierarchical network architecture. If the Commission ever wanted to take a huge step backwards in terms of network design, COBAK would fit the bill. Because COBAK encourages the deployment of network facilities using the same architecture as ILECs, it assumes that the ILEC network architecture is the best solution and reduces innovation in network architecture.

4. <u>Bill-and-keep would convey enormous competitive advantages to ILECs</u>

- With their substantially larger customer base, ILECs would have enormous competitive advantages under a bill-and-keep regime. To recover the loss of terminating compensation currently paid by carriers, an ILEC would be able to impose very small rate increases over its entire customer base (assuming the Commission will not engage in thorough review of cross-subsidization), while a CLEC would be required to impose high rate increases over its smaller set of customers. Further, to the ILEC, a loss of terminating compensation for traffic to high-volume inbound customers could be offset by not having to pay terminating compensation for traffic generated by high-volume outbound customers. Unless the CLEC had a high-volume outbound-traffic customer for each high-volume inbound-traffic customer, CLECs would have to raise rates on its customers while the ILEC would not. Only if services are priced according to marginal cost, so that there is no cross-subsidization across customers with varying traffic patterns, could bill-and-keep work. But then the Commission would be swapping one form of price regulation for another. The problem is not arbitrage opportunities, the problem is the lack of a fully functional competitive market. If the market were truly competitive, arbitrage opportunities would be short-term by necessity.
    - While cost-based intercarrier compensation will require regulatory review of terminating switching rates, this would be far more focused and narrowly tailored than a review of all ILEC service rates and costs to eliminate cross-subsidies. In addition, the major ILECs have a considerable incentive to keep terminating switching rates low in order to minimize their own payments to their competitors.

- The burdens of implementing bill-and-keep would fall disproportionately on CLECs. The great majority of calls originated on the ILEC network are also terminated on the ILEC network. Since this traffic is already handled, in effect, on a bill-and-keep basis by the ILEC, moving to bill-and-keep will alter compensation arrangements for only a small portion of ILEC-originated and ILEC-terminated traffic. On the other hand, since the great majority of traffic originated on the CLEC network is terminated on the ILEC network, and the great majority of traffic terminated on the CLEC network is originated on the ILEC network, moving to bill-and-keep will alter compensation arrangements for virtually all of the CLEC's traffic.

- Bill-and-keep would have a disproportionate impact on rural ILECs that receive a substantial portion of revenues from above-cost access charges. Unless these revenues are replaced through additional universal service payments or an increase in end user fees, the Commission can expect reductions in telephone penetration rates, harms to the financial solvency of small ILECs, and degradation in service quality as network maintenance costs are reduced to offset revenue losses.

5. Bill-and-keep would distort the pricing signals in the communications market

- The calling party causes the incremental costs of a call. The costs of a call are the result of the call itself, and the decision to make a call is made by the calling party. That decision should be driven by the calling party comparing the price of the call to their desire to make the call. If the other party wants to obtain the benefit of the call, they are free to originate a call and bear the cost.

- The distortion caused by shifting the cost of a call to the called party can be seen in impact of Spam-email. With email, the sending party does not bear the terminating costs of the messages they send. The result is a flood of unwanted messages. No other network industry (postage, airlines, trucking) forces receiving parties to pay for delivery – it is always the originating customer unless the receiving customer volunteers to pay for the carriage.

- The arbitrage opportunity offered by bill-and-keep would lead to unintended market impacts. Customers that originate more calls than they receive would become more valuable to carriers (assuming there is market resistance to changing the current "calling party pays" paradigm). Customers that neither made nor received calls could become the target of discounted service (the carrier could avoid originating and terminating switching costs). Since the current system is firmly set to "calling party pays" for retail relationships, the actual adaptation of carriers and customers to such a global change cannot be predicted.

6. Cost-Based Intercarrier Compensation reflects how real-world competitive markets work. Bill-and-Keep is a radical restructuring of a critical market based on an unsupported theory (COBAK).

- Bill-and-keep represents a radical departure from the intercarrier compensation regimes established in the early 1980s and modified over time. Under such a radical restructuring of costs, retail pricing would be forced to change in a similarly radical manner.

- Retaining the existing "calling party pays" compensation model, but revising it to be unified, cost-based, and comprehensive, would achieve the stated policy goals of the Commission without abandoning 25 years of industry experience, and without abandoning the sum of economic thought regarding competitive markets.

- The numerous difficult issues associated with migration to a bill-and-keep scheme, such as the ICF proposal, illustrate the extent it is a departure from the existing model. Cost-based intercarrier compensation boils down to only a handful of regulatory changes—selecting a proper rate that is compensable without creating arbitrage opportunities, and identifying a revenue source to offset losses from eliminating universal service subsidies from access charges.